

Subject: Post Office and Civil Service Committee Hearing on the Supplemental Retirement Plan for Federal Employees; 3 April 1985.

I. The first segment of the hearing was a presentation by a panel of six personnel officers representing DoD, NIH, Agriculture, NASA, FDA and the Treasury Department. (Attachment A) Each panelist presented a brief summary of the current status of their Agency's employment roles, citing the number of current employees and how many of those are presently contributing to the Social Security retirement system. In addition, each panelist made general comments on their Agency's experience in attempting to recruit/hire new employees since January 1984. None of the comments on this subject offered any new problems or situations deserving of special note.

The Committee Chairman, William D. Ford (Michigan) queried the panel about reports that the civil service retirement statistics for the month of December 1984 was the highest monthly percentage of retirements in recent times. None of the panelists could provide specific statistics on retirements from their agency during the month of December 1984, however, all agreed that it was an unusually high monthly percentage for retirements. This question generated some interesting comments by the panelists, viz;

- NASA has a serious concern about preserving their top management.... 25% of NASA's management level officers are eligible for immediate retirement. The experience and skills of most of these management personnel in NASA is readily marketable in the private sector. Many recent NASA retirees have been successful in landing jobs in the private sector that pay up to 2 1/2 times their NASA salary.

- NIH is experiencing a problem in retaining young medical doctors, medical technicians, etc., as long-term careerists. These specialists are interested in the portable retirement programs that are offered to their peers with private organizations/associations. NIH offers only the civil service retirement program that is not transferable when these specialists leave the government service for jobs in the private sector. With the portable retirement programs that are available to medical specialists in the private sector, a doctor/technician can move from one employer to another while continuing in the same retirement program/system for his/her entire career.

- New government employees with marketable specialties (tax specialists, accountants, lawyers, etc.) are indicating that they do not plan to make a career of government service. They are using their present government service/experience as preparation for long-term service in the private sector where financial rewards (salaries) are much greater.

-- The government "quit-rate" versus the private sector "quit-rate" was discussed briefly. When a civil servant transfers from one agency to another agency they are not actually quitting government service. However, no statistics are kept on such movements. Based on this premise -- government quit-rate is not nearly as high as the private-sector quit-rate.

The Chairman expressed his appreciation for the testimony of the panel members and commented that they are in the unique position of having a direct interest in the hiring/retiring activities of their respective agencies because of the positions that they occupy. Consequently, their testimony has reason to be objective, and free of political, union, or Administration special interests.

II. The second segment of the hearing was made up of presentations by individual states (New York, Michigan, and Maryland) retirement system administrators. (Attachment B) Each official briefly described his state's current retirement system with a special mention of how the Social Security annuity system is involved. In general, each state's retirement system is somewhat complex, because each state has been attempting to provide improved optional retirement systems, based on changing laws. Each state has several tiers in their retirement programs. None of the states represented appears to offer any outstanding programs - however, each state is making a concerted effort to assist state employees to prepare for financially comfortable retirement years. One common factor in each of individual state retirement systems was the use of the Social Security retirement system as an integral part of the retirement package.

Two noteworthy subjects presented by the state officials were:

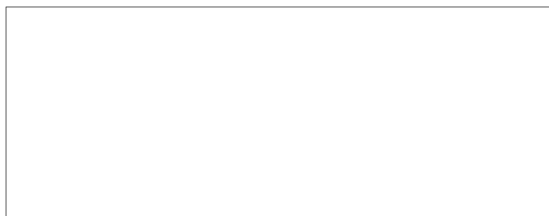
(A) They are making extensive use of the "457 Plan" as part of the retirement package. The "457 Plan" has recently become available for participation by state-government employees. In the past, it has been an investment program available only to employees of private companies. The "457 Plan" is a tax deferred investment plan which allows limited contributions by the employee, with no matching contributions by the employer. The "457 Plan" option has been favorably received by state government employees and state retirement systems administrators as well.

(B) The characteristics of health insurance programs are becoming of increasing interest to state-government employees.

III. The final segment of the hearing was a presentation by Mr. L. J. "Lud" Andolsek, the President of the National Association of Retired Federal Employees (NARFE). His presentation is attached. (Attachment C)

IV. The next hearing on the Supplemental Retirement Plan by the Committee is scheduled for 23 April 1985.

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OP/RD/RSB

House of Representatives

Committee on Post Office and Civil Service

Washington, D.C. 20515

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COMMITTEE ON POST OFFICE AND CIVIL SERVICE
CONTINUATION OF HEARINGS ON SUPPLEMENTAL RETIREMENT PLAN
Wednesday, April 3, 1985

WITNESS LIST

1. PANEL OF FEDERAL PERSONNEL OFFICIALS:

Paul T. Weiss, Director, Office of Personnel, Department
of the Treasury;

Gerald F. Meyer, Associate Commissioner for Management
and Operations, Food and Drug Administration;

Carl E. Grant, Director, Personnel Programs Division,
National Aeronautics and Space Administration;

William J. Riley, Jr., Director of Personnel, Department
of Agriculture;

Philip S. Chen, Jr., Associate Director for Intramural
Affairs, National Institutes of Health; and

Frank P. Cipolla, Director, Personnel Management, Office
of Civilian Personnel Policy and Requirements,
Department of Defense.

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2. PANEL OF STATE GOVERNMENT PENSION ADMINISTRATORS:

Bennett Shaver, Executive Director, Maryland State Retirement and Pension System;

Richard Beers, Director, Michigan Bureau of Retirement Systems, Department of Management and Budget; and

John McManaman, Assistant Deputy Comptroller, New York State Employees Retirement System.

3. Lud Andolsek, President, National Association of Retired Federal Employees



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TREASURER

STATEMENT OF
THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES
BEFORE THE
HOUSE COMMITTEE ON POST OFFICE AND CIVIL SERVICE
ON THE DESIGN OF A SUPPLEMENTAL RETIREMENT PROGRAM
FOR
FEDERAL EMPLOYEES HIRED AFTER 1983

WEDNESDAY, APRIL 3, 1985

I am L. J. "Lud" Andolsek, President of the National Association of Retired Federal Employees (NARFE). It is pleasure to appear before this Committee to assist in the construction of a supplemental retirement program for new employees. Although the benefits of this program will not directly affect our members who are already retired, we feel privileged to provide you with a look at this important matter through the eyes of age.

We, more than anyone else, recognize the legitimate purposes of a retirement system. As former government managers, we understand the need to provide a sensible progression into retirement for older workers so that new generations can take over the reins. As current retirees we, more than others, recognize the income replacement and security needs of those who have completed their careers as productive wage earners, and earned the right to retire with security. As patriotic citizens we agree with the legitimate need for a social safety net established in our national policies for half a century, which is most often achieved through retirement programs provided by employers for the productive members of our society and their families.

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Finally, as those who have felt the ebb and flow of political winds enrich and then threaten our dignity and security, we recognize the need to insulate this new program as much as possible from political pressures. This means neither hiding it nor putting it totally beyond the reach of political leaders. What it does mean is constructing a plan which is consistent with private sector practices while recognizing the unique needs and mission of a unique employer -- the government. It means creating a program which both employees and the public can understand and view as fair; and it means guaranteeing the program's fiscal health through an unwavering commitment by the U. S. government itself.

Mr. Chairman, in my testimony today I will take a few minutes to describe the objectives that NARFE regards as crucial to the design of a federal retirement program to supplement Social Security. I will then turn to the specific issues mentioned in your letter of invitation to this hearing and comment on each of those issues.

NARFE believes it is important to design a new plan that will satisfy several major goals:

- o It should provide an adequate retirement income for the new employees across the full spectrum of job classifications and salary grades;
- o It should be a program that will (be) fair to new hires, the 5 million employees and annuitants still under the current Civil Service Retirement System, and the public;
- o It should be funded in a manner that will protect the financial integrity of the current system into the future;

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- o It should meet the federal government's continuing need to attract and retain a quality workforce that can execute the many different functions of government at the high performance level to which the American taxpayer is entitled.

How do we translate these goals into a supplemental retirement program? One part of the answer is to keep those elements of the current system that have been most important in meeting these objectives in the past. That means having a total benefit including Social Security that replaces a substantial portion of the final salary for the long-term employee. It means maintaining a flexible retirement age policy that permits the long-term employee to elect retirement with an adequate income after 30 years of service. It means protecting all retirees and survivors against the devastating consequences of inflation in old age.

But the new system has to include new elements as well. These new elements should reflect the role that Social Security will play in the lives of the new hires and their families; the new system should take advantage of recent private-sector innovations to encourage personal retirement saving; and the new system should not unduly penalize employees who find it necessary to interrupt their government careers before reaching retirement age.

Our organization has devoted a great deal of thought to this matter over the past two years. Although we remain flexible on many of the specific features, we have developed a viewpoint on the direction we think the system design should take.

First, we have concluded that a three-tier retirement system is needed. The first tier, Social Security, will provide the basic floor of protection.

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The second tier should be a supplemental defined benefit plan with benefits tied to the high-three average salary and years of service. These two tiers will provide employees with a retirement income level that can be predicted in advance of reaching retirement age and that should provide an adequate retirement replacement income for those employees with modest salaries.

For those who want a greater retirement income than these first two tiers can provide, a third tier is needed. This third tier should be a voluntary thrift plan to which employees are encouraged to contribute through tax-deferred status and agency matching contributions on their behalf.

Second, we think that an expanded group life insurance program makes sense as an element of survivor protection in this system. Group life could be provided to all new hires relatively cheaply and would become an important adjunct to Social Security survivor benefits and elective surviving spouse annuities.

Third, we feel strongly that this system for new hires should be just that — a system for new hires. To allow those now under Civil Service Retirement to opt into this new system, as some have discussed, could endanger the current retirement system. Congress would have to amend the Social Security Act to allow optional individual participation in Social Security since such optional participation by individuals is not now, nor has it ever been, allowed under law. Given the current climate, we feel it is simply unrealistic to believe that the Congress will allow individual civil servants to decide whether or not it is to their personal benefit to participate in Social Security. If Congress was forced to address this issue, it more likely would choose to mandate Social Security coverage for major additional categories of federal and postal employees. This political

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employees. This political risk outweighs any advantages that might accrue from giving current employees an option.

Now, Mr. Chairman, I will turn to the particular questions you raised in your letter.

Cost of a Supplemental Retirement System

When Congress acted in 1983 to extend Social Security coverage to new federal and postal employees, it did so as a part of a comprehensive measure to avoid an impending insolvency in the Social Security trust funds. This legislation did not bear at all on the question of whether the Civil Service Retirement System costs too much or too little. In fact, House action on that 1983 bill was accompanied by an excellent statement of support for the existing level of Civil Service Retirement benefits signed by the distinguished Chairman of this Committee and two of his colleagues -- the Speaker of the House and the Chairman of the House Committee on Ways and Means.

Given that background, and the need to develop a retirement system for new hires that is fair both to them and to employees and retirees under the existing system, the design of the supplemental should be undertaken on a cost-neutral basis. By that we mean that the cost to government of the supplementary system should be close to that of the current system. By "cost" we mean the share of payroll needed to pay for the future benefits that newly entering workers will someday receive.

It is critical to the quality of the federal work force for Congress to ignore the Administration's call for a cheaper retirement program. The excellent study done for this Committee by Hay Associates demonstrates that federal employees lag well behind their private-sector counterparts when it comes to overall compensation. Only the value of the federal retirement plan keeps the compensation gap from being truly horrendous. To enact a bargain-basement

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retirement plan for new hires as OPM Director Donald Devine advocates will make it impossible for federal agencies to compete with the top corporations in recruiting skilled employees. You know the old saying: "You get what you pay for." It is crucial that Congress recognizes that a federal retirement system is not just another spending program for budgeteers to whack away at each year. A retirement system is a part of the price we pay for good employees. We need a system for new hires that assists in the recruitment and retention of such employees.

Given NARFE's belief that within a total compensation framework the cost of the current system is legitimate, we believe this cost factor should be retained in the new program. We recognize, however, that the technical ability of the experts to measure the equivalence of two quite different retirement programs may not permit a fine-tuning of a plan design that will achieve exact equality. The Congressional Research Service has recently published an estimate that the current retirement system costs the government 24.7 percent of payroll. They estimate that the federal cost of social security coverage for federal employees is 6.1 percent of payroll. These two figures imply that a supplemental plan should cost 18.6 percent of payroll so that, when added to the 6.1 percent for Social Security, it would equal the current system's cost.

However, all of these estimates are very sensitive to assumptions about future pay increases, interest rates, and so on. The Social Security estimate even depends on Congress leaving in place the payroll tax hikes now scheduled for future years. I think that the supplemental plan's cost should be close to that target level of 18.6 percent of payroll, but we should not pretend that an exact equivalence can be measured to everyone's satisfaction.

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Relating Supplemental Benefits to Social Security

The Social Security program is a program that provides retirement income; but it is also a program designed to improve the adequacy of income in old age. Thus, unlike a typical staff retirement plan that pays annuities that replace the same proportion of salary for all employees with the same length of service, Social Security benefits replace more of a person's wages at the lower end of the wage scale. This "tilt" in the Social Security benefit formula poses a problem for retirement plan designers, since an employer must decide whether to design the staff retirement plan in a way that offsets the "tilt" to some degree.

This issue has led to the development of a complex set of federal rules for ways in which retirement plans can be integrated with Social Security. A plan that fails to comply with those rules is denied a tax exemption for the earnings of the plan's assets.

One policy implication that emerges from these integration rules is that a company plan cannot fully offset the relative advantage Social Security gives to lower-wage employees. The federal government should abide by this policy in designing the supplemental plan for its own employees. A national policy aimed at giving the lower-wage worker a break should not be completely overturned by employers, whether private or public. Additionally, should the public employer be allowed to ignore the rules it places on private employers, an unfair and politically volatile situation is created.

Should the federal plan at least partially offset the Social Security "tilt"? There are two approaches used by private plans that do this:

(1) the offset method, in which a fraction of the Social Security benefit

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is deducted from the full entitlement under the employer plan; and (2) the step-rate method, in which employees at the higher salary levels accrue benefits from the employer plan at a faster rate than do lower-paid employees.

These integration methods make sense in a large corporation, where the variation in salary is enormous, ranging from minimum-wage jobs on up to six-figure executive positions. In a federal plan, these integration methods make little sense because the salary range is much narrower and the salary concentration of employees at the time of retirement is narrower still. An offset or step-rate formula would have relatively little impact on overall wage-replacement rates in a federal system compared to a non-integrated add-on formula.

Mr. Chairman, I would like to submit a chart for the hearing record that illustrates this point. The chart shows an example of an add-on plan, an offset plan, and a step-rate plan that replace the same amount of salary after 30 years of service. When you add Social Security, you get a total wage replacement rate that is higher for the \$15,000 worker than for the more highly paid workers. The offset or step-rate plans narrow this differential compared to the add-on plan, but the degree to which it is narrowed is not that great.

At the lower end of the salary scale, the offset plan yields a total replacement rate of 60.9 percent, which is 4.3 percentage points less than for the non-integrated add-on plan. The step-rate plan does not differ from the add-on plan below the salary level at which the accrual rate changes, which is \$39,600 in this example.

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At the \$60,000 salary level, the integrated plans both raise the replacement rate compared to the add-on plan, but only by 4.8 points for the offset plan and 5.9 points for the step-rate plan.

In summary, a supplement that is integrated with Social Security would do little to make wage replacement rates more uniform across the government's salary range; but integration would increase the plan's complexity and make it harder to gain understanding and acceptance. A tax-deferred thrift plan, which would benefit all employees but especially highly paid employees, could accomplish the objective of integration without the drawbacks.

Employee Contributions

In the private sector, employees do not contribute to defined benefit plans. All contributions are made by the employer, which amounts to a tax subsidy for private employees and employers since this employer-provided payment is not subject to taxation as individual income, and employers may write off their retirement expenses as a cost of doing business.

In the public sector, employees have traditionally contributed to their retirement plans. Since pay and benefits of public employees are often under political attack, the employees' having a direct stake in the plan's funding has been an important source of political strength in warding off these attacks. For this reason, some degree of employee contributions should continue in any new supplemental plan.

Another reason to require employee contributions is to maintain parity with the current system to the extent possible. Establishing a 1.3 percent employee contribution rate would achieve parity for employees earning less

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than the Social Security maximum taxable wage base (\$39,600 this year). The combined rate for Social Security and the new plan would be 8.35 percent, which is equivalent to the Civil Service Retirement and Medicare contributions that federal and postal employees currently pay.

In 1986 and 1987, the 8.35 percent combined rate will rise to 8.45 percent due to a Medicare tax increase. In 1988, the Social Security tax will increase, causing the total contribution rate for the new hires system to rise to 8.81 percent while the current system's combined rate would stay at 8.45 percent. As such divergence occurs and as Congress may act in the future to change the Social Security and Medicare tax rates, the Committee might want to consider automatically adjusting the contribution rate to avoid development of a substantial difference in the total rates for the two systems. I would like to submit a chart for the record that shows how this divergence in rates would occur over time.

Financing the System

In regard to the overall financing of the system, we should maintain the approach now followed for the current system. Funds should flow into the Civil Service Retirement Trust Fund from the employee, from the agency, and from general revenues, and benefits should be paid out by the Trust Fund. While the accountants and actuaries will want to keep track of the cost of the supplemental plan separately, its funds should not be isolated from those of the current Trust Fund. It will be important for the continued strength of Civil Service Retirement that the unity of program funding for all federal and postal employees be maintained.

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We see no purpose in full advance funding of a federal retirement system. As the Chairman of this Committee has often observed, the government is not about to go out of business, so there is no analogy to the need to protect benefits rights in pension plans of private businesses which can fail. Government funds should not be squirrelled away to insure against such a meaningless contingency as the government going into default.

The Committee may want to consider limiting the need to use general revenues for the supplemental plan by relying more on agency matching contributions. Currently, the agency matches its employee's 7-percent contribution with another 7 percent. If the employee pays 1.3 percent under the supplemental plan, the agency requirement could be kept at 7 percent. There would be two advantages to doing this. First, it would make the cost to the agency of new hires and old-law employees the same. Second, it would mean that a smaller share of the supplemental system's cost is borne by general revenues transfer than is the case for the current system.

Vesting

The current Civil Service Retirement system has a vesting period of 5 years, a relatively short requirement compared to private-sector plans, which often set vesting at 10 years. It has been important historically for Civil Service to have a fairly short vesting period for at least two reasons. First, there was no Social Security coverage that could be carried along to a new job and built upon. Second, there was no thrift plan or profit-sharing plan in which an employee could build individual equity. When a civil servant left government, it was vital that he or she had some right to a federal annuity since these portable benefits available in the private sector were not available in government.

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The vesting requirement clearly needs rethinking in designing the supplemental plan. The new hires have Social Security coverage, and the new system may well include a thrift plan. Thus, a short vesting period will not be as critical as in the past. On the other hand, a mobile work force can be hurt by failure to vest when vesting requirements are longer than the duration of job tenure for a large proportion of employees.

I do not think that the Committee would want to consider a vesting period longer than the ten years set by ERISA as a minimum standard for the private sector. On the other hand, the 5-year period may not be needed in the supplemental system. Within this range, the period could be set at a particular length to meet the overall system's cost objective.

Closely related to vesting is the issue of the portability of accrued benefit rights when an employee leaves the government. We urge the Committee to consider ways in which a vested employee can retain his or her benefit rights without a substantial loss in the real value as time passes and inflation takes its toll between the date of separation and the date of retirement. One possible approach would be to index accrued benefits by the amount of general federal pay increases. Another approach would be to let separating employees elect to roll their accrued benefits into a thrift plan and accrue earnings on those assets on a tax-deferred basis.

Special Employee Groups

We understand the Committee plans to hold another hearing to discuss the special retirement situations of such groups as the air traffic controllers and federal law enforcement officers and firefighters. I will limit my remarks on this subject to one observation. The considerations which

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led Congress in the past to provide special retirement rules for these groups have not changed. Therefore, whatever the design of the supplemental plan, it should incorporate provisions that satisfy the unique circumstances of these employee groups in a manner that is consistent with the way they have been treated under current law. Congress shouldn't reinvent the wheel, but just make sure it stays round.

To conclude, Mr. Chairman, we appreciate the opportunity to testify here today. The mission which you have undertaken will set new policy that will determine the shape of federal benefits for many years to come. It will potentially lead to changes in private-sector policies as well. NARFE wishes you well in this endeavor, and stands ready to work with you in developing a good retirement system for the post-1983 employees, while maintaining the fiscal and moral integrity of the current Civil Service Retirement System on which millions continue to depend.

Gross Wage-Replacement Rates Under Social Security
and Alternative Federal Supplemental Retirement Plans
for a 62-Year-Old Retiree with 30 Years of Service

	<u>Final Salary</u>			
	<u>\$15,000</u>	<u>\$30,000</u>	<u>\$45,000</u>	<u>\$60,000</u>
Gross wage-replacement rates ^a from:				
Social Security ^b	30.7%	22.3%	17.0%	12.8%
Supplemental add-on plan ^c	34.5	34.5	34.5	34.5
Total Incl. Social Security	(65.2)	(56.8)	(51.5)	(47.3)
Supplemental offset plan ^d	30.2	34.5	37.2	39.3
Total incl. Social Security	(60.9)	(56.8)	(54.2)	(52.1)
Supplemental step-rate plan ^e	34.5	34.5	36.6	40.4
Total incl. Social Security	(65.2)	(56.8)	(53.6)	(53.2)

Notes:

^a Wage replacement rates were obtained by dividing retirement benefit by final salary.

^b Social Security benefits were calculated using the early retirement reduction factor of 30 percent that will apply after the normal retirement age is raised to 67. The final salary (or, if lower, the taxable wage ceiling of \$39,600) was used as the average indexed monthly earnings in the benefit formula.

^c The benefit accrual rate for this plan is 0.95 percent for each of the first ten years of service and 1.25 percent for each additional year. The final salary was used as the high-3 average salary.

^d A benefit accrual rate of 1.525 percent per year of service was used, reduced by 50 percent of the Social Security benefit. The final salary was used as the high-3 average salary.

^e A benefit accrual rate of 1.15 percent per year of service was used for salary up to the taxable wage ceiling of \$39,600; above that level, a rate of 1.725 percent was used. The final salary was used as the high-3 average salary.

Employee Contribution Rates under Current
Civil Service Retirement System and Supplemental Plan for New Hires

Supplemental Plan for New Hires

<u>Year</u>	<u>Social Security</u>	<u>Medicare</u>	<u>Supplemental Plan</u>	<u>Total</u>
1985	5.7	1.35	1.3	8.35
1986	5.7	1.45	1.3	8.45
1987	5.7	1.45	1.3	8.45
1988	6.06	1.45	1.3	8.81
1989	6.06	1.45	1.3	8.81
1990	6.2	1.45	1.3	8.95
and thereafter				

Current System (CSRS)

<u>Year</u>	<u>Medicare</u>	<u>Civil Service Retirement</u>	<u>Total</u>
1985	1.35	7.0	8.35
1986	1.45	7.0	8.45
1987	1.45	7.0	8.45
1988	1.45	7.0	8.45
1989	1.45	7.0	8.45
1990	1.45	7.0	8.45
and thereafter			